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SUBJECT: IMF KRUEGER AND WORLD BANK LINN DELIVER TOUGH
MESSAGE ON ECONOMIC REFORM

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¶1. (SBU) Summary: IMF Deputy Managing Director Krueger delivered a tough message to Prime Minister Gul and the rest of the GOT January 16, stressing that the government needed to implement the economic reform program in light of its "dangerous" financial situation. She and World Bank VP Linn, who told Ambassador January 17 that he would deliver an equally tough message, warned the Turks that any third party assistance (i.e., from the U.S.) would only offset the impact of an Iraq operation, and could not substitute for sound policy. Gul and others told Krueger that, while there had been some problems, they were now focused on the need to implement the program, and would be meeting January 18 to consider additional fiscal measures to meet the 6.5 percent primary surplus target. However, proposed GOT amendments to the Public Procurement Law and the GOT's "tax amnesty" remain serious problems in the eyes of the Fund and Bank. Fund staff will review the situation again next week, based on the expected new fiscal measures and hoped-for draft LOI. Meanwhile, Embassy will continue to push the reform message with GOT officials and parliamentarians (septel). End Summary.

Krueger Delivers Tough Message

¶2. (SBU) IMF Deputy Managing Director Anne Krueger started with two meetings in Istanbul January 15: with TUSIAD (Turkish Industrialists and Businessmen's Association) Chairman Ozilhan, and Banks Association President Ozince. Krueger's main point in those meetings - that any extra financing that Turkey may receive in the event of an Iraq operation is no substitute for good economic policy - was not conveyed accurately to the Turkish press. Ozilhan told the press that the IMF was contemplating additional financing. The IMF promptly issued press statements both in Ankara and Washington denying that she said this. (Comment: In meantime, the Ozilhan statement temporarily buoyed local financial markets.)

¶3. (SBU) In Ankara, Krueger met both senior government civil servants (Treasury Undersecretary Oztrak, Banking Board Chairman Akcakoca, Central Bank Governor Serdengecti), and AK Cabinet members (PM Gul, Deputy PM Sener, State Minister Babacan, Finance Minister Unakitan). IMF resrep said her message on sticking with reforms got increasingly tough throughout the day, and was especially tough by the time she met with PM Gul in the evening, which was one of the most substantive meetings.

¶4. (SBU) Krueger told Gul the IMF is concerned with the lack of focus on economic policy, and that the financial situation was "dangerous" given the GOT's precarious cash position. This is no time to be complacent on reforms, she continued, and financing from other sources (referring to potential U.S. assistance in the event of Iraq) would help address Iraq-related losses but would be no substitute for good policy. She said several issues need to be resolved before the IMF can be completed, mentioning the fiscal measures to reach a 6.5 percent of GNP primary surplus, agreement on the Pamuk and Yapi Kredi Banks, and implementation of the Public Procurement Law.

¶5. (SBU) Gul replied, per Resrep, that he had a lot of issues, including Iraq, but he is now focused on economic policy. The Higher Planning Council (Note: a subset of the full Cabinet) will meet on January 18 to consider a new set of fiscal saving measures. Gul said he is talking with the

Chairman of the Supreme Administrative Court (Danistay) to get early court resolution of the Pamuk Bank case (though we understand Danistay will not be able to hear the case quickly). Gul was less clear on the Public Procurement Law, noting only that the law was in effect as of January 1, as scheduled. (Comment: The problem is that the law is not being implemented, and AK has proposed legislative amendments now in parliamentary committee to limit the law.)

¶16. (SBU) In response to Gul's question on what was needed to bring the IMF Mission back to Turkey, Krueger did not give a detailed response, per IMF resrep ("her role is not to negotiate," he said, "but they know our concerns.") But the brief IMF press statement released after her meetings on January 16 concluded with the sentence: "As soon as the government has clarified its concrete policy plans further, we stand ready to send an IMF mission to Ankara to discuss the 2003 budget another issues key to the program." This sentence was the local press lead on January 17 (and we understand caused some concern among both Turkish officials and emerging market bond traders in London).

¶17. (SBU) Krueger's other interlocutors "read from the same script" and kept to generalities. Deputy PM Sener highlighted the strong privatization program announced January 15. (IMF is checking whether the TEKEL privatization plan has been adopted by the High Privatization Council, which would meet a Fourth Review prior action.) Asked about the "Tax Peace" or amnesty law passed by parliament January 17, resrep noted that the version as passed contained some amendments proposed by IMF staff. For instance, the cut-off date for tax arrearages subject to the amnesty was pushed back to 2001 (the original draft included arrearages accumulated as recently as October 2002, right before the elections.) However, any tax amnesty needs to include measures to strengthen tax administration, in order to send a credible signal of resolve on tax collection. The IMF staff would have to verify that the right amendments were included; if so, the law would not be a "show stopper" for the Fourth Review.

¶18. (SBU) Looking forward, Krueger will meet with AK Chairman Erdogan in Davos to reiterate her tough message. Following the January 18 Higher Planning Council meeting, at which fiscal measures are expected to be adopted, the IMF may send out a team of technical fiscal experts to work with the GOT on the budget. The full 2003 budget is scheduled to be submitted to the Higher Planning Council on January 28, and be passed by parliament on February 5, before the Muslim holiday. Resrep believes the full IMF Mission may well be delayed until after the February 11-14 holiday.

World Bank's Linn Equally Tough

¶19. (SBU) In a breakfast meeting with the Ambassador January 17, World Bank Vice President Johannes Linn said he planned to deliver a similarly tough message in his meetings, including with PM Gul. For the World Bank, adoption of the Public Procurement Law amendments is a show stopper (i.e., it would result in suspending some \$900 million in public sector adjustment loans scheduled for 2003).

¶10. (SBU) Linn was pessimistic about the GOT's fiscal sustainability, saying that even a 6.5 percent of GNP primary surplus may not be sufficient for 2003. Like the IMF's Krueger, he planned to deliver a tough message on the "Turkish perception of moral hazard in the potential U.S. assistance package." The Ambassador assured Linn that the U.S. has many times told the GOT of the economic reform conditionality in any potential U.S. assistance. The Prime Minister and others know that is our position.

¶11. (SBU) Linn said the Bank will remind the Turks of World Bank anti-poverty programs, which are an AK priority. First, the World Bank assists the GOT's Social Solidarity Fund, which provides winter fuel, school supplies, and food to the poorest segment of Turkish society (in 2002, this was only funded at TL 875 trillion - about \$500 million). Second, the Bank is supporting the Direct Income Support program for farmers, currently funded at about 1 percent of GNP. The Bank says Turkish Treasury deliberately delays these payments, in order to harness resources for other payment needs, and the World Bank wants to improve delivery of this key antipoverty measure.

¶12. (SBU) Linn concluded that World Bank assistance on this and other GOT priorities is endangered by the Public

Procurement Law amendments, fiscal spending measures and other concerns.
PEARSON